No. 2588

In the

United States Circuit Court of Appeals

For the Ninth Circuit

M. A. MILLER, Collector of Internal Revenue for the District of Oregon, and DAVID M. DUNNE,
Plaintiffs in Error,

vs.

SNAKE RIVER VALLEY RAILROAD COMPANY, a corporation,
Defendant in error.

Brief of Defendant in Error

Upon Writ of Error to the District Court of the United States for the District of Oregon

CLARENCE L. REAMES, United States Attorney for Oregon, and E. A. Johnson, Assistant United States Attorney, both of Portland, Oregon, Attorneys for Plaintiffs in Error.

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STATEMENT OF FACTS

The statement made by plaintiffs in error seems to cover the case in a general way, and we do not deem it necessary to re-state the facts, other than to call the court's attention to the fact that the plaintiffs in error, set up in their answer, different activities which the

defendant in error was engaged in during the taxing year of 1910, and claim that such facts constituted, "a doing of business," within Section 38 of the Act of August 5, 1909, known as the Corporate Income Tax Act. Defendant in error demurred to the answer, and in sustaining the demurrer Mr. Justice Bean filed a memorandum opinion as follows:

"These four cases are brought against the Collector of Internal Revenue to recover sums of money paid by the respective plaintiffs under protest as corporation taxes, under the Act of Congress of August 5, 1909. The plaintiff in each case had leased its road to another company, which was operating it during the taxing year in question, and, therefore, in my opinion, was not doing business within the meaning of the Corporation Tax Act. I am unable to distinguish the cases from that of McCoach vs. Minehill Railroad Company, 228 U. S. 295, in which the Supreme Court held that a railroad company which has leased its railroad to another company, operating it exclusively, and which maintains its corporate existence and collects and distributes to its stockholders the rentals from the lessee, and also dividends from investments, is not doing business within the meaning of the Corporation Tax Act. The demurrers to the answers will therefore be sustained." (Page 28, Trans. Record.)

The plaintiffs in error, as is shown on page 29 of the Transcript of Record, elected to stand upon their answers, and thereupon defendant in error filed a motion for judgment on the pleadings, which motion was sustained. The only question presented, therefore, is whether

or not defendant in error was doing business during the taxing year of 1910, within the meaning of the Act of 1909.

POINTS AND AUTHORITIES

I.

The corporation tax is imposed upon the doing of corporate business and with respect to the carrying on thereof, and not upon the franchises, or property, of the corporation, irrespective of their use in business.

McCoach vs. Minehill Ry. Co., 228 U. S. 295-300.
Flint vs. Stone Tracey Co., 220 U. S. 107-145.
Zonne vs. Minneapolis Syndicate, 220 U. S. 187-191.
U. S. vs. Whitridge, 231 U. S. 144-147.
Von Baumback vs. Sargent Land Co., 219 Fed. 35-44.
U. S. vs. Nipissing Mines Co., 206 Fed. 431-433.
Anderson vs. Morris, Etc. Ry., 216 Fed. 83-89.
Wilkes-Barre Traction Co. vs. Davis, 214 Fed. 511-512.
New York Central Ry. Co. vs. Gill, 219 Fed. 184-185.
Public Service Railway vs. Herold, 219 Fed. 301-305.
Emery Bird, Etc. Co. vs. U. S., 198 Fed. 242-250. Affirmed by U. S. Sup. Ct. April 5, 1915.

II.

The mere receipt of income from the property leased, and the receipt of interest and dividends from invested funds, bank balances, and the like, and the distribution thereof among the stockholders, amounts to no more

than receiving the ordinary fruits that arise from the ownership of property.

36 Stat., Sec. 28, Ch. 6, Pages 11, 112, 117.

McCoach vs. Minehill, Etc. Ry. Co., 228 U. S. 295-300.

ARGUMENT

The lease in question (Trans. Record, p. 18 *et seq.*) states among other things:

First. The lessor hereby leases to the lessee, its successors and assigns, from the first day of July, 1907, for the term of five years then next ensuing, the railroad of the lessor, together with all equipment and appurtenances of every kind and nature whatsoever to the said railroad belonging or appertaining.

Third. The lessee (The Oregon Railroad & Navigation Company) will operate the said railroad and will pay the expenses of operation, maintenance, repairs and renewals thereof, and all incidental expenses connected therewith, and the sums payable for taxes and assessments upon the demised premises."

It is conceded that the defendant in error did not operate the railroad in question during the taxing year of 1910, but the Government contends that the defendant in error was doing business within the taxing year, by reason of engaging in activities, such as maintaining general offices in the City of Portland, maintaining its corporate existence by the holding of stockholders' meetings and the business incident thereto, in collecting the income and rents accruing by virtue of the lease of its

property, managing its finances, reimbursing the lessee for the construction of a warehouse track and passing track and a cattle passway, cancelling the lease in question, selling the property and paying its bonded indebtedness, as well as paying its state annual corporate licenses.

The Corporation Tax Law (Act of August 5, 1909, Sec. 38, 36 Stat., Ch. 6, pp. 11, 112-117), provides: "That every corporation * * * organized for profit * * * and having a capital stock represented by shares * * * and engaged in business in any state * * * shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation * * * equivalent to one per centum upon the entire net income over and above $5,000.00 received by it from all sources during such year, exclusive of amounts received by it as dividends upon stock of other corporations * * * subject to the tax imposed.

"Such net income shall be ascertained by deducting from the gross amount of the income of such corporation * * * received within the year from all sources (first) all the ordinary and necessary expenses actually paid within the year out of income in the maintenance and operation of its business and properties, including all charges, such as rentals or franchise payments, required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation of property. * * *"

Our position is that the defendant in error was organ-

ized for the purpose of operating a railroad, and on the 29th day of June, 1907, it leased its entire railroad to the Oregon Railroad & Navigation Company, which lessee company undertook and did operate said railroad until the 23rd day of December, 1910, at which time the property of the defendant in error, as well as the property of the Orgon Railroad & Navigation Company, the lessee, was sold to the Oregon-Washington Railroad & Navigation Company.

The United States Supreme Court has held that the statute imposed a special excise tax * * * not upon the franchise of a corporation, irrespective of their use in business, nor upon the property of the corporation, but upon the doing of corporate business and with respect to the carrying on thereof * * * the tax is not payable unless there be a carrying on or doing of business in a corporate capacity, and this is made the occasion for the tax, measured by the standard prescribed. The difference between the acts (that is to say, the act in question and the Income Tax Act held to be unconstitutional in the Pollock Case) is not merely nominal, but rests upon substantial differences between the mere ownership of property and the actual doing of business in a certain way. Flint vs. Stone Tracey Co., 220 U. S. 144-45-50.

Having in mind the substantial distinction thus clearly indicated by this court, the question in the present case reduces itself to this: Whether the Snake River Valley Railroad Company's stockholders in their corporate capacity are mere landlords—owners, that is, of the property from which they derive an income—or whether

they are actually engaged in business within the meaning of the act.

The act and the decisions clearly show that it was the intent and purpose of Congress to tax the railroad activities of a corporation when the corporation was engaged in the business for which it was organized, and that it is not the intent of Congress to tax a corporation which has leased its entire railroad to another concern, which is operating the road, and is doing nothing more than receiving the ordinary fruits that arise from the ownership of property.

We believe that the United States Supreme Court and other Federal Courts have expressly held, that each and every activity which the Government advances as the doing of business by the Snake River Valley Railroad Company, during the taxing year of 1910, does not constitute a doing of business within the meaning of the act, and amounts to nothing more than maintaining the investment, collecting the income and such other incidental matters arising therefrom.

The leading case on this question is McCoach vs. Minehill Railroad Co., 228 U. S. 295, in which the Court states, among other things:

"A railroad corporation which has leased its railroad to another company, operating it exclusively, but which maintains its corporate existence and collects and distributes to its stockholders the rental received from the lessee, and also dividends from the investments, is not doing business within the meaning of the Corporation Tax Act." The Court saying (page 303): "In our opinion, the mere receipt of income from the property

leased (the property being used in business by the lessee and not by the lessor), and the receipt of interest and dividends from invested funds, bank balances, and the like, and the distribution thereof, amount to no more than receiving the ordinary fruits that arise from the ownership of property. * * * The distinction is between (page 308):

"(a) The receipt of income from outside property or investments, by a company that is otherwise engaged in business, in which event the investment income may be added to the business income, in order to arrive at the measure of tax, and

"(b) The receipt of income from property or investments by a company that is not engaged in business, except the business of owning the property, maintaining the investments, collecting the income and dividing it among the stockholders. In the former case the tax is payable, in the latter not."

In United States vs. Whitridge, 231 U. S. 144, the Court held that a receiver operating a streetcar system was not doing business within the meaning of the Corporation Tax Law. The Court said (page 148):

"The Corporation Tax Law imposed an excise tax on the doing of business by corporations, and not in any sense tax on property or upon income merely as such. * * * It does not in terms impose a tax upon corporate property or franchises as such, nor upon the income arising from the conduct of business unless it is carried on by the corporation. * * * It does not impose a tax upon the income derived from the management of corporate property by receivers under the conditions of this case."

In Flint vs. Stone Tracy Co., 220 U. S. 107-145, it was said: "The tax is imposed, not upon the franchises of a corporation, irrespective of their use in business, nor upon the property of the corporation, but upon the doing of corporate or insurance business, and with respect to the carrying on thereof, in a sum equivalent to one per centum upon the entire net income over and above $5,000.00, received from all sources during the year, and when imposed in this manner it is a tax upon the doing of business with the advantages which inhere in the peculiarities of corporate or joint stock organizations of the character described. As the latter organizations share many benefits of corporate organization, it may be described generally as a tax upon the doing of business in a corporate capacity."

This interpretation was followed and made the basis of the decision in McCoach vs. Minehill Railroad Co., 228 U. S. 295-300, and U. S. vs. Whitridge, 231 U. S. 144-48, and again in Zonne vs. Minneapolis Syndicate, 220 U. S. 187-191, in which last mentioned case the Court observed:

"A corporation, the sole purpose whereof is to hold title to a single parcel of real estate, subject to a long lease, and for convenience of the stockholders, to receive and distribute the rentals arising from such lease and proceeds of disposition of the land, and which has disqualified itself from doing any other business, is not a corporation doing business within the meaning of the corporation tax provisions of the Act of August 5, 1909, Sec. 38, 36 Stat., Chap. 6, pages 11, 112-117, and is not subject to the tax."

In New York Central Ry. Co. vs. Gill, 219 Fed. 184-185, the rule laid down in McCoach vs. Minehill Railroad Co., 228 U. S. 295, was again followed. It appeared that the railroad leased its property to another railroad corporation, which operated the same, the lessor continuing its corporate existence only for the purpose of collecting the rental and maintaining the investment and doing other things incident thereto. The Court held that such activities was not "doing business" within the meaning of the act.

The same result was reached in United States vs. Nipissing Mines Co., 206 Fed. 431-433, in which it appeared the defendent corporation was organized to own the stock of a mining company, and had no assets except such stock, a small amount in the bank, office furniture, etc., and did nothing other than receive dividends from the operating company and distribute them as such among its own stockholders. It was held this was not "doing business" within the meaning of the act.

In an effort to make it appear that the receipt of income under the lease, constitutes a doing of business, the Government refers to the real estate company cases argued and decided in Flint vs. Stone Tracy Co., 220 U. S. 111. These were all cases in which the corporate charters showed that the managing, leasing and selling of property was the purpose which had led to the formation of these companies. The making of leases as a means of exploiting property was one of the corporate objects. The right to deal in real estate by lease or sale was a consequence of the franchise; the corporation was chartered to manage and make sales of real estate,

and was so engaged. It follows, of course, it was doing the business for which it was formed and existed. If the activity is the managing and rental of real estate for profit, then to engage in that activity is the doing of business, and it was so held in the cases referred to.

It was in reference to these cases that the United States Supreme Court said, in the Zonne case: "We have held in the proceeding cases that corporations organized for profit under the laws of the state, authorized to manage and rent real estate, and being so engaged, are doing business within the meaning of the law, and are therefore liable to the tax imposed."

But the real estate cases are not authority for the proposition, that a corporation chartered to operate a railroad, but which has leased its entire railroad to another company, and has practically gone out of business and thus divested itself of all its railroad and authority so to operate, can ever be taxed as doing business, simply because it owns the property and maintains its investment.

It is significant, that in no one of the real estate cases, did their counsel make the argument that the corporations had gone out of business, and the reason was two-fold: First, the companies had not gone out of business, but were engaged in the business for which they had been chartered; second, even if the companies had gone out of business, they dared not plead this for an excuse, because the result would have been the forfeiture of their charter for non-user.

It is clear, therefore, that the case at bar is governed and controlled by the McCoach case, 228 U. S. 295, and

the Zonne case, 220 U. S. 187, and the Whitridge case, 231 U. S. 144, and other cases following and adopting the rule laid down in these cases, as shown under Points and Authorities No. 1.

We submit, therefore, that the Snake River Valley Railroad Company was not doing business within the meaning of the Corporation Tax Law during the taxing year of 1910, and that the railroad company's demurrer to the Government's further and separate answer was properly sustained and the judgment entered thereon in favor of the defendant in error should be affirmed.

Respectfully submitted,

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